Advanced **Markets**

Insurance LLCs

Client guide

INSURANCE PRODUCTS	
MAY LOSE VALUE	NOT A DEPOSIT
NOT BANK GUARANTEED	NOT FDIC INSURED
NOT INSURED BY ANY GOVERNMENT AGENCY	

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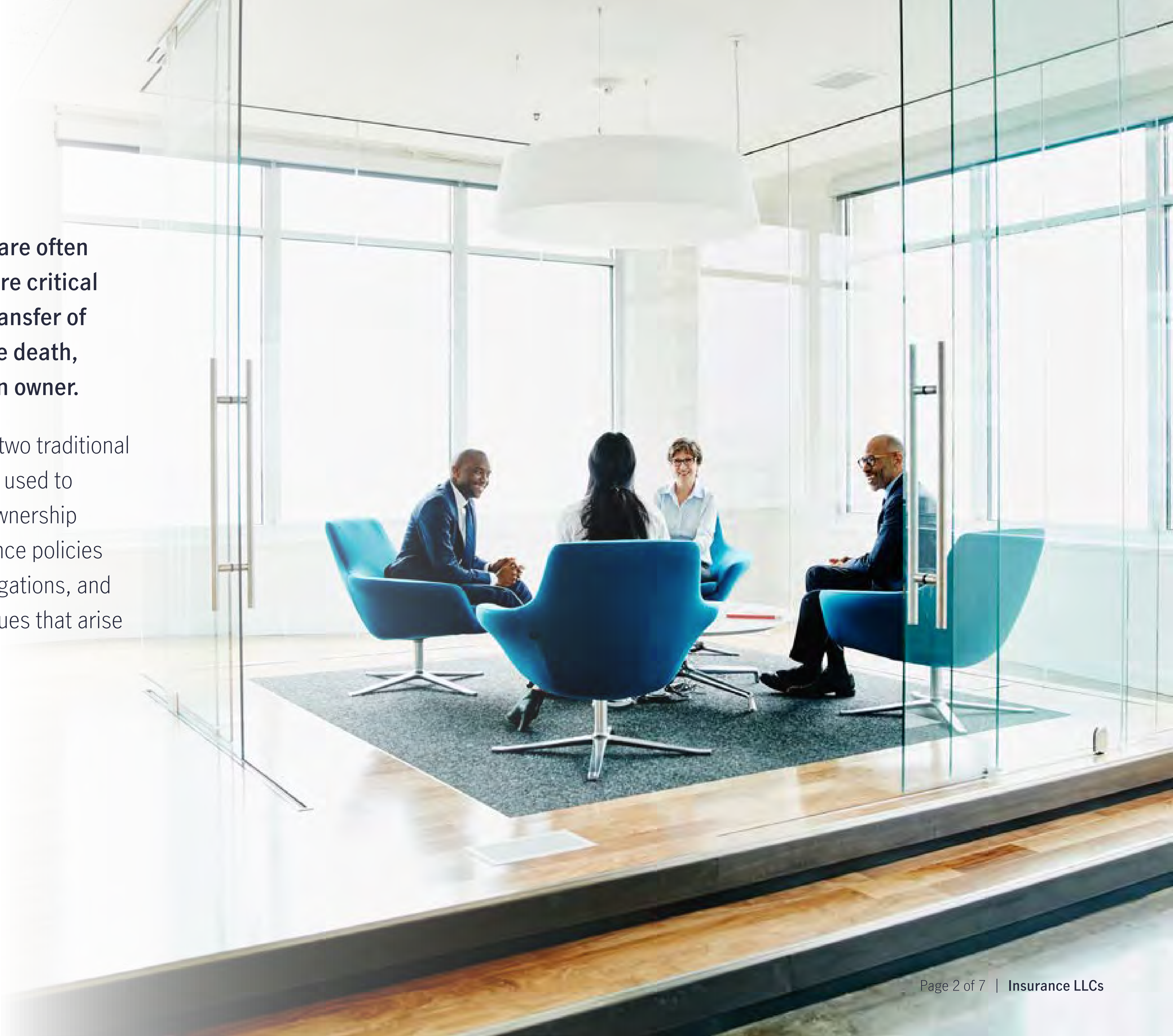
Overview

Buy-sell agreements, which are often funded with life insurance, are critical to help ensure the orderly transfer of business ownership upon the death, disability, or retirement of an owner.

The Insurance LLC, a hybrid of two traditional buy-sell arrangements, is often used to create more efficiency in the ownership and management of life insurance policies purchased to fund buy-sell obligations, and can help avoid common tax issues that arise under other arrangements.



Traditional buy-sell agreements

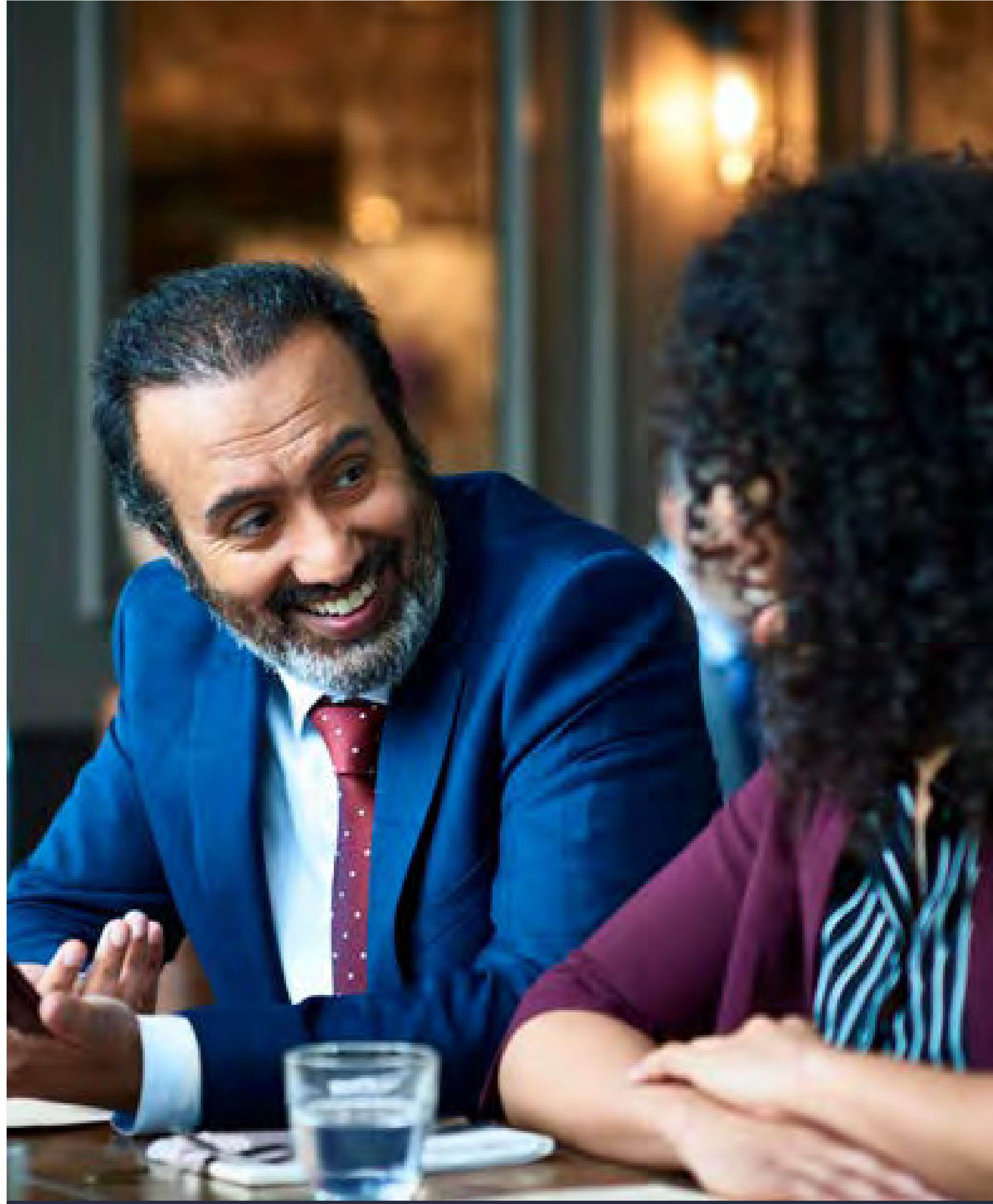
A buy-sell agreement is a formal contract between you and your fellow business owners that lays out what will happen to each owner's share of the business upon a "triggering event," such as disability, retirement, or death. A well-drafted and properly funded arrangement can protect your family and help facilitate the continuation of the business. Traditional buy-sell agreements are often structured and funded in one of two ways.

Cross-purchase plan

- Each owner agrees to personally buy a departing owner's interest upon a triggering event
- Each business owner purchases life insurance on the lives of the other owners

Entity-purchase plan

- The business entity agrees to buy back a departing owner's interest upon a triggering event
- The business purchases life insurance policies on the lives of the business owner



While both plans offer many benefits, there are several notable drawbacks with traditional buy-sell agreements, leading some business owners to seek alternative structures that are easier to administer and more adaptable to changing family and/or business needs.

Insurance LLC agreements

An Insurance LLC may be a compelling alternative to a traditional cross-purchase or entity-purchase buy-sell design. The Insurance LLC strategy combines a buy-sell agreement with a limited liability company (LLC) created to own and administer life insurance policies on you and your co-owners' lives that will fulfill each owner's obligations under your buy-sell agreement.

To properly prepare for both lifetime buyouts and those occurring at the death of an owner, permanent life insurance is often preferable to term because it provides both death benefit coverage and the opportunity to build policy cash value that can be used or leveraged to help fund lifetime obligations.

How it works

1 Form the LLC

You and your co-owners create an LLC taxed as a partnership. The LLC is separate from your primary business and is created to administer your buy-sell agreement, which includes owning life insurance to fund the purchase obligations under your agreement. This agreement will also specify what is to happen to the co-owners' interests in the LLC when an owner departs from the primary business.

2 Draft a buy-sell agreement

An attorney drafts a buy-sell agreement with you and your co-owners as the parties to the agreement. The buy-sell agreement will generally provide that in the case of a triggering event, your interest in the primary business will be purchased by your remaining co-owners, and vice versa.

3 Purchase life insurance on each owner

To fund the buyout of your primary business and your Insurance LLC interests, the Insurance LLC will purchase a permanent life insurance policy on each owner.

How it works, *continued*

4

Make ongoing payments of life insurance premiums

You and each of your co-owners will transfer money to the LLC as a contribution to fund the policy premiums. You will work with your co-owners to come to an agreement regarding the source of funds. For example, the business can make additional distributions to you and your co-owners, or the business may lend premiums to the Insurance LLC as part of a formal lending arrangement.

5

Leverage life insurance upon an owner's death or departure

Upon the death of an owner, the life insurance death benefit will generally be paid income tax-free to the LLC to facilitate the underlying buy-sell agreement. The death benefit will be used to both liquidate the deceased owner's interest in the Insurance LLC and by the surviving owners to buy out the business interests of the deceased owner in accordance with the buy-sell agreement. The surviving owners will receive a basis increase in the value of their company interests and the family of the deceased owner will receive cash equal to the market value of their business interests.

Upon the departure of an owner (i.e., lifetime buyout), the policy owned on the departing owner can be transferred to that owner as part of the liquidation from the Insurance LLC and buyout from the primary business. The owner can then use the policy's cash value as a potential source of tax-free discretionary income during their retirement years and as death benefit protection for their family. To the extent the policy's value is insufficient to cover the full purchase price under the buy-sell agreement, any shortfall can be made up by tapping into the cash values of the other policies held by the Insurance LLC, via bank loans, or in installments paid over time.

Benefits

Utilizing an Insurance LLC to facilitate the administration of your business's buy-sell agreement offers many potential benefits, including:

Simplicity

Only one policy per owner is needed

Promoting equity among owners

Premium funding disparities related to age, health, or ownership percentage can be addressed through negotiation among all owners

Flexibility

New owners can be incorporated into the agreement with relative simplicity

Creditor protection

Policies are protected from debts of primary business and of individual owners

Limits transfer-for-value concerns

This technique may help avoid transfer-for-value issues that often arise, especially as new owners come into the business and others leave

Step-up in basis

The surviving owners receive a step-up in basis on the purchased interests of a departing owner, which can help reduce tax burdens for the surviving owners if the business is later sold

Estate tax exclusion

Life insurance proceeds can be excluded from the deceased owner's taxable estate with proper planning

Important considerations

Estate taxes

Owners must work with legal counsel to ensure that the terms of the LLC operating agreement meet certain requirements and do not inadvertently create estate tax inclusion

Employer-owned insurance

Business owners should comply with §101(j) requirements, including Notice and Consent

Ongoing management and coordination with the planning team

These plans require a level of sophistication and coordination with financial professionals, including attorneys and CPAs

Is an Insurance LLC right for you?

A buy-sell agreement is one of the most important ways to help ensure both your business and family are financially protected. An Insurance LLC can be a compelling alternative to traditional buy-sell options, eliminating some of the drawbacks of these standard plans and providing administrative flexibility, tax advantages, and more.

For more information on these plans or to create a customized plan design, please consult with your financial professional.

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Loans and withdrawals will reduce the death benefit and the cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Withdrawals in excess of the cost basis (premiums paid) will be subject to tax and certain withdrawals within the first 15 years may be subject to recapture tax. Additionally, policies classified as modified endowment contracts may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½. (Cash value available for loans and withdrawals may be more or less than originally invested.) Withdrawals are available after the first policy year.

Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions such as when a life insurance policy has been transferred for valuable consideration.

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